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IN THE
SUPREME COURT OF THE UNITED STATES
SUMMER TERM, 1981

NO. 80-2211

SMITH BARNEY, HARRIS
UPHAM & CO., INC.,

Petitioner,

vs.

WENDEE HENRICKSEN,

Respondent.

BRIEF FOR RESPONDENT

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Dated: July 23, 1981

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vs.

WENDEE HENRICKSEN,

Respondent.

BRIEF FOR RESPONDENT

STATEMENT OF THE CASE

The respondent Wendee Henricksen sued the petitioner Smith Barney, Harris Upham & Co., Inc. ("Smith Barney") and George Henricksen for the common law claim of conversion, the common law claim of breach of fiduciary duty, and for violations of the securities laws including sec. 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. §78j) and Securities and Exchange Commission Rule 10b-5 (17 C.F.R. §240.10b-5). The claims against Smith Barney were based upon respondeat superior as to the common law claims and upon both respondeat superior and sec. 20(a) of the Securities Exchange Act of 1934 (15 U.S.C. §78t(a)) as to the securities law claims.

The respondent's claims were based on the fact that she deposited blue chip securities with a value of $113,000 into a Smith Barney discretionary account with a long-term growth investment objective in January of 1976 and that by November of 1977 her account had a value of zero. The trial court awarded the respondent complete recovery against George Henricksen and set forth the components of the damages as follows:

1. $55,356.91 of converted funds under both the common law claim of conversion and the securities law claim under sec. 10(b) and Rule 10b-5;

2. $33,564.31 of losses on call purchases under both the common law claim of breach of fiduciary duty and the securities law claim under sec 10(b) and Rule 10b-5; and

3. $21,754.65 of commissions and margin account interest under both the common law claim of breach of fiduciary duty and the securities law claim under sec. 10(b) and Rule 10b-5.

The trial court, however, only awarded the respondent recovery against Smith Barney as to the third element of the above damages.

The trial court held that Smith Barney had no liability under respondeat superior as to any of the claims, because the respondent had a discretionary account as opposed to a nondiscretionary account. The trial court held that this created a dual agency and thus eliminated the normal agency liability rules that would apply in an employment situation.

The trial court further held that Smith Barney had no liability under sec. 20(a) of the Securities

Exchange Act of 1934 as to the securities law claims, since the trial court found that Smith Barney had enforced its reasonably adequate system of internal supervision and control with reasonable diligence. In making this determination, the trial court again held that a discretionary account involved a dual agency. The trial court held that this created a lighter duty of supervision for Smith Barney.

The trial court's award of damages against Smith Barney as to the $21,754.65 of commissions and margin account interest was based upon the trial court's application of common law principles of unjust enrichment.

The respondent appealed to the United States Court of Appeals for the Seventh Circuit from that portion of the trial court's judgment denying recovery against Smith Barney. The essence of the respondent's appeal was that the trial court had made an error of law as to the nature of and duties flowing from a discretionary account. Smith Barney cross-appealed upon the basis that it should not have been found liable under unjust enrichment, if it was not liable under respondeat superior or sec. 20(a) of the Securities Exchange Act. George Henricksen did not appeal.

The Seventh Circuit held that the trial court had made an error of law as to the nature of and duties flowing from a discretionary account. The Court ruled that, in undertaking a discretionary account, Smith Barney actually "took upon itself a far more stringent fiduciary responsibility than it undertakes with respect to nondiscretionary accounts" (App. at A-12). The Seventh Circuit held that this error of law had affected the trial court's findings on both the respondeat superior issue and the sec. 20(a) issue.

The Seventh Circuit held that Smith Barney was liable to the respondent under respondeat superior

as to all of her damages under her common law claims and her securities law claims. As noted above, all of the respondent's recoveries against George Henricksen had an independent common law basis in addition to a securities law basis. The Seventh Circuit further held that Smith Barney also was liable to the respondent under sec. 20(a) as to all of her damages under her securities law claims which occurred after October of 1976.

Smith Barney then filed a petition for rehearing en banc which was denied.

Smith Barney then filed a petition for certiorari with this Court.

ARGUMENT

I. There is No Case or Controversy Before This Court.

There currently is no real case or controversy before this Court. This is due to the limited issues raised by Smith Barney in its petition for certiorari.

As set forth in the Statement of the Case, the respondent's entire recovery against George Henricksen has a common law basis in either conversion or breach of fiduciary duty. Smith Barney does not raise any issue as to its liability under the common law doctrine of respondeat superior for George Henricksen's common law violations of conversion and breach of fiduciary duty.

Smith Barney could not reasonably raise any such issue. For example, at page nine of its petition herein, Smith Barney cites the Ninth Circuit as one of the circuits which has held that sec. 20(a) is the exclusive means of vicarious liability of broker-dealers for the securities law violations of their employees. In Mihara v. Dean Witter & Co., 619 F.2d 814 (9th Cir. 1980), the

plaintiff recovered a judgment against a broker-dealer and one of its employees under both a common law claim of breach of fiduciary duty and a securities law claim under sec. 10(b) and Rule 10b-5. On appeal the defendants raised an issue as to respondeat superior, which the Ninth Circuit disposed of as follows:

> "The contention that the Court incorrectly instructed the jury regarding the applicability of respondeat superior to a 10b-5 claim is also unsupported by the record. The Court gave the respondeat superior instruction in connection with the fiduciary duty claim, and limited it to that claim." (619 F.2d at p.825)

Smith Barney also does not contend that sec. 20(a) of the Securities Exchange Act has anything to do with the common law claims of conversion and breach of fiduciary duty. Sec. 20(a) provides that it only applies where one is "liable under any provision of this chapter or of any rule or regulation thereunder ...." Furthermore, sec. 28(a) of the Securities Exchange Act of 1934 provides that, "The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity ...."

The respondent Wendee Henricksen, therefore, submits that a writ of certiorari in this matter would have no effect on the case and controversy between her and Smith Barney. She is entitled to complete recovery against Smith Barney based solely on her common law claims. The petition for certiorari should be denied on this basis alone.

II. Two of the Three Issues in the Petition for Certiorari were not Raised Below, and the Other Issue was Raised Only in the Petition for Rehearing.

Smith Barney raises three issues in its petition for certiorari. The first issue is as to respondeat superior liability of a broker-dealer for its employees' securities law violations. The second and third issues are as to the need for scienter on the part of a broker-dealer in order to be liable under sec. 20(a) for the securities act violations of its employees.

The first issue was raised only in Smith Barney's Seventh Circuit petition for rehearing en banc. In its brief on the appeal to the Seventh Circuit, Smith Barney raised no such issue. Its only reference to the matter of respondeat superior liability as to securities law violations was an aside in a footnote. (R. App. A-2)

The second and third issues as to scienter under sec. 20(a) were not raised in any manner, shape or form before the Seventh Circuit in either the appeal or the petition for rehearing. Neither the trial court nor the Seventh Circuit was ever called upon to determine whether Smith Barney was guilty of scienter within the facts of this case.

As to this manner of raising issues, this court has stated:

> "This issue was not raised in the Court of Appeals. Only in exceptional cases will this Court review a question not raised in the court below." Lawn v. United States, 355 U.S. 339, 362, fn. 16 (1958)

and

> "This Court sits as a court of review. It is only in exceptional cases coming here from the federal courts that questions not pressed or passed upon below are reviewed. [citations omitted]" Duignan v. United States, 274 U.S. 195, 200 (1927)

This Court has embodied this principle in Supreme Court Rule 15(g) which provides in relevant part that, "The statement of the case shall also specify the stage in the proceedings (both in the court of first instance and in the appellate court) at which the questions sought to be reviewed were raised; the method or manner of raising them; and the way in which they were passed upon by the court".

See also United States v. Santana, 427 U.S. 38, 41, fn. 2 (1976); United States v. Ortiz, 422 U.S. 891, 898 (1975); R. Stern and E. Gressman, Supreme Court Practice (5th Ed. 1978), sec. 6.27.

It is submitted that none of the issues in the petition for certiorari hearing were properly raised in the court below, and that certiorari should be denied on that basis alone.

III. The Position of Smith Barney as to Respondeat Superior Liability is Incorrect.

The respondent Wendee Henricksen chooses not to respond in any manner to the second and third issues as to scienter raised by Smith Barney on this petition, since those issues were not even hinted at at any place in this entire litigation until the filing of this petition for certiorari. At no time did Smith Barney argue to either the trial court or the appellate court that it was necessary that there be a determination as to the scienter of Smith Barney.

As to the issue of respondeat superior liability for securities law violations of a broker-dealer's employees, which issue was raised for the first time on the petition for rehearing, the respondent notes that these issues recently were squarely posed to the Second Circuit and Fifth Circuit. The respondent will rely on the explications of law in Marbury Management, Inc. v. Kohn, 629 F.2d 705 (2nd Cir. 1980), cert. den. sub. nom. Wood Walker & Co. v. Marbury Management, Inc., 101 S. Ct. 566, 66 L. Ed.2d 469 (1980) and Paul F. Newton & Co. v. Texas Commerce Bank, 630 F.2d 1111 (5th Cir. 1980), pet. for reh. en banc den., 634 F.2d 1355.

The respondent also notes that, contrary to the statement by Smith Barney in footnote 5 on page 9 of its petition, the United States Court of Appeals for the Third Circuit has changed its position on this issue and now would recognize the respondeat superior liability of a broker-dealer in addition to its sec. 20(a) liability for its employees' securities law violations. In Sharp v. Coopers & Lybrand, Fed. Sec. L. Rep. (CCH) ¶97,971 (3rd Cir. 1981), the Third Circuit, in discussing respondeat superior liability for employees' securities law violations, distinguished broker-dealers from other employers due to broker-dealers owing a higher duty to their customers. Indeed, the Third Circuit stated that the decision of the Seventh Circuit in this very case was consistent with the decision of the Third Circuit in that case and that the Third Circuit drew support from the Seventh Circuit decision in this case! (pages 91,013 - 91,014)

The respondent also notes that two Fourth Circuit panels have held that a broker-dealer has respondeat superior liability for the securities law violations of its employees. Johns Hopkins University v. Hutton, 422 F.2d 1124 (4th Cir. 1970), cert. den., 416 U.S. 916 (1974) and Carras v. Burns, 516 F.2d 251 (4th Cir. 1975). Another

panel, without citing the above two earlier decisions, has held that there is no such liability. Carpenter v. Harris, Upham & Co., Inc., 594 F.2d 388 (4th Cir. 1979), cert. den., 444 U.S. 868 (1979). Thus, the final position of the Fourth Circuit on this issue must await a future decision.

The respondent further agrees with the position of the Fifth Circuit in Paul F. Newton & Co. v. Texas Commerce Bank, (supra, at 630 F.2d 1117, fn. 5) which notes that the Ninth Circuit has never directly focused on the issue of a broker-dealer's respondeat superior liability for the securities law violations of its employees.

Thus, it is submitted that any split among the circuits as to the respondeat superior liability of broker-dealers for the securities law violations of their employees is healing.

CONCLUSION

There currently is no case or controversy between Wendee Henricksen and Smith Barney, since Smith Barney has raised no issue in its petition for certiorari as to its respondeat superior liability for the common law violations of conversion and breach of fiduciary duty.

Two of the three issues raised by Smith Barney in its petition for certiorari were never raised in any form whatsoever in either the Seventh Circuit or the trial court. The other issue was raised for the first time in Smith Barney's petition to the Seventh Circuit for a rehearing en banc.

The appeal to the Seventh Circuit revolved around the nature of a discretionary account and not around the issues that are now being raised by

Smith Barney. The petition for writ of certiorari should be denied.

Respectfully submitted,

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APPENDIX

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Docket Nos. 80-1488 and 80-1584

WENDEE HENRICKSEN,

Plaintiff-Appellant
and Cross-Appellee,

vs.

SMITH BARNEY, HARRIS UPHAM & CO., INC.,

Defendant-Appellee
and Cross-Appellant.

On Appeal From the United States District Court for the Eastern District of Wisconsin

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BRIEF OF DEFENDANT-APPELLEE AND CROSS-APPELLANT SMITH BARNEY, HARRIS UPHAM & CO., INC.

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[Excerpt from page 26]

Observing the rule this circuit established in Fey v. Walston & Co., Inc., 493 F.2d 1036 (7th Cir. 1974), the district court held that even though not liable under Section 20(a) of the Securities and Exchange Act of 1934, Smith Barney could conceivably be liable for George Henricksen's conduct under a respondeat superior theory.[15]

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[15] Other circuits are divided on the issue of whether respondeat superior should even be considered a basis for relief independent of Section 20(a) of the Securities and Exchange Act of 1934. Compare, Christoffel v. E.F. Hutton & Co., 588 F.2d 665, 667 (9th Cir. 1978) ("the established law of [the 9th] Circuit [is] that section 20(a) supplants vicarious liability of an employer for the acts of an employee applying the respondeat superior doctrine.") with, Marbury Management, Inc. v. Kohn et al, CCH Fed. Sec. L. Rptr. ¶97,357 (2d Cir. 1980). The circuits refusing to expand the scope of brokerage firm liability to include liability under the respondeat superior theory are clearly correct. Like allowing a private cause of action for a merely negligent violation of an association or stock exchange rule, permitting liability under the doctrine of respondeat superior would nullify "the carefully drawn restrictions surrounding the major anti-fraud provisions of the Exchange Act." See, Zagari v. Dean Witter & Co., Inc., CCH Fed. Sec. L. Rptr. §95,777 at p. 90,812 (N.D. Cal. 1976).